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20 December, 2012

Ms J Owens MP
Committee Chair
Standing Committee on Economics
House of Representatives
CANBERRA ACT 2600

Sent by email to: economics.reps@aph.gov.au

Submission to Committee Reviewing Tax Law Changes - Schedule 7 (relating to proposed changes to in-house fringe benefits) contained in Tax Laws Amendment (2012 Measures No 6) Bill 2012

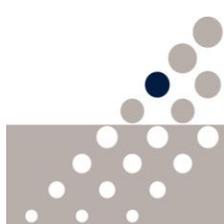
The Independent Schools Council of Australia (ISCA) welcomes the opportunity to present this submission to the Standing Committee on Economics (the Committee) in response to the Committee's Media Release issued on 6 December 2012. ISCA is the peak national body covering the independent schools sector which also comprises the eight state and territory Associations of Independent Schools. Through these Associations, ISCA represents a sector with 1,090 schools and around 550,000 students, accounting for nearly 16 per cent of Australian school enrolments. ISCA's major role is to bring the unique needs of independent schools to the attention of the Australian Government and to represent the sector on national issues.

Independent School Structures

Independent schools are a diverse group of non-government, not-for-profit (NFP) schools serving a range of different communities. Many independent schools provide a religious or values-based education. Others promote a particular educational philosophy or interpretation of mainstream education.

Their legal structures can be diverse with many falling into the following categories:

- Schools that are fully owned by a church (e.g. some Uniting Church Schools);
- Schools established by state Acts of Parliament with the specific purpose of establishing the school as a charitable institution (e.g. some Grammar Schools);
- Schools which are an administrative unit operating within an Association or "system" owned by a church;
- Schools which are a company. Many of these are limited by guarantee and assets can be owned by an underlying church property trust. In some cases the company owns the school outright;
- Public benevolent institutions (e.g. some Indigenous Schools).



Some schools with common aims, religious affiliations and/or educational philosophies also belong to a system within the sector. This means that some operational functions are carried out by the system on behalf of all schools within the system. However, all schools have formal boards of governors or committees of management who are the key decision-making bodies for most independent schools and are responsible for issues such as the school's educational provision, current and future development and staffing.

Independent School Affiliations

Many independent schools are faith-based schools with varying degrees of legal and administrative links to their church bodies encompassing the full spectrum of faiths across the Australian community including not only the well-known Anglican, Uniting Church and Catholic schools, but also Lutheran, Baptist, Seventh Day Adventist, Islamic, Greek Orthodox, Christian and Jewish schools. Table 1 below provides a breakdown of the affiliations of independent schools.

Table 1: Affiliations of independent schools, 2011

Affiliation	Schools	Student FTE	%
Anglican	151	139,915	25.3%
Non-Denominational	187	72,325	13.1%
Christian Schools	134	55,731	10.1%
Uniting Church in Australia	44	50,344	9.1%
Catholic	59	47,903	8.7%
Lutheran	86	37,410	6.8%
Islamic	33	21,576	3.9%
Baptist	43	18,647	3.4%
Inter-Denominational	27	16,592	3.0%
Seventh Day Adventist	48	11,147	2.0%
Presbyterian	14	9,961	1.8%
Jewish	19	8,899	1.6%
Steiner School	43	7,687	1.4%
Pentecostal	17	7,465	1.4%
Assemblies of God	11	5,635	1.0%
Brethren	8	4,514	0.8%
Montessori School	39	4,098	0.7%
Greek Orthodox	8	3,760	0.7%
Other Catholic	7	3,441	0.6%
Other Orthodox	6	2,092	0.4%
Other Religious Affiliation*	12	5,238	0.9%
Other**	90	18,381	3.3%

For further information on independent schools, see attachment 1, *“Independent School Facts”*

* Other Religious includes Churches of Christ, Ananda Marga, Hare Krishna and Society of Friends

** Other includes special schools, international schools, indigenous schools, and community schools.

Independent School Funding and Reporting

The Australian Government is the source of most of the public funding for non-government schools and in order to be eligible for this funding assistance, non-government schools must be NFP institutions and comply with a wide range of legislative requirements. This requirement is made clear in the *Schools Assistance Act 2008* Administrative Guidelines: Commonwealth Programs for Non-government Schools 2009 to 2013/14 which state under the Commonwealth's requirements for eligibility for Commonwealth funding:

“The memorandum and articles or other instruments by which incorporation is effected must:

- a) include the power of the incorporated body to conduct a school; and*
- b) provide for the non-profit status of the body including a requirement that any surpluses generated by the school, or recognised group of non-government schools be used for the purposes of the school or recognised group of non-government schools and not be transferred to any other activity that the body is authorised to undertake.”*

Schools are obliged to work co-operatively with their state or territory government to support that government in fulfilling its obligations under the National Education Agreement. Independent schools must also agree to support the achievement of the National Declaration on Educational Goals for Young Australians and the Council of Australian Governments (COAG) outcomes for schooling.

Schools must participate in all specified National Student Assessments, participate in the preparation of the National Report on Schooling in Australia, collect and provide extensive information relating to individual students and school information to all organisations specified in the Regulations, including the Australian Government Department of Education, Employment and Workplace Relations (DEEWR) and the Australian Curriculum, Assessment and Reporting Authority (ACARA). Schools are also required to report to parents in compliance with legislated requirements, annually report and publish specified information relating to particular aspects of the school and its operations and implement the national curriculum.

Independent schools must submit to DEEWR annually a Financial Questionnaire. The Financial Questionnaire is an annual collection of financial income, expenditure and liabilities from all non-government schools receiving Australian Government general recurrent grants. The Financial Questionnaire data draws on a school's audited financial statements. Schools are also subject to scrutiny of their financial operations including the financial viability and funding sources of the school. Independent schools must demonstrate that the funds received under each Australian Government funding program have been expended appropriately. This includes providing the Australian Government with certificates certified by qualified accountants regarding the expenditure of Australian Government grants. All accounts, records and documents as well as free access to each campus of a school must be available to the Auditor-General or DEEWR officers.

Independent schools are bound by a number of other legal requirements associated with their operations. For example, as companies limited by guarantee or as incorporated associations, independent schools are accountable to the Australian Securities and Investments Commission (ASIC), or to their state or territory registrar of associations. They must submit audited financial statements to these bodies which are available for public scrutiny. They are also subject to regulation by the Australian Taxation Office.

As employers, independent schools must comply with legislation and regulations covering such issues as occupational health and safety and industrial awards. As educational institutions they must also comply with health and safety, privacy and child protection requirements, town planning requirements,

human rights and equal opportunities legislation, as well as regulations relating to building and fire codes.

“My School” web site (operated by ACARA) offers an additional and easily accessible level of transparency to the operations of schools in all sectors. ACARA collates and publishes a range of student outcomes and performance indicators of school services, including a comprehensive overview of the financial aspects of a school’s operations.

The Commonwealth, through the Minister for School Education, Early Childhood and Youth, The Hon Peter Garrett AM MP, is also proposing to State and Territory Governments that there is a need “to improve regulatory harmonisation for the purposes of administering public funding to non-government schools”. This proposal is being considered by the Standing Council on School Education and Early Childhood (SCSEEC), of which the Commonwealth, State and Territory Government Ministers are the only members. There is no non-government representative on this forum. There are a number of key areas in these reforms, with the objective being:

To achieve greater consistency and clarity in the eligibility criteria of non-government schools for public funds, and the appropriate use and accountability of these funds across all jurisdictions.

Key areas of the project plan include:

- *Operation of not-for-profit requirement*
- *Minimum viability standards for schools*
- *Claim for, and use of, recurrent funding*
- *Joint investigations and issue management*

In addition to the impact of the proposed “harmonisation” project, schools are already under considerable reform pressure in relation to funding, curriculum and potential reporting reforms (DEEWR and ACARA). As an already highly regulated charity, each non-government school (both independent and Catholic) must now comply with a new range of Australian Charities and Not-for-profit Commission (ACNC) regulatory reforms recently enacted by the Australian Government.

Current Government NFP Tax Reform Initiatives

In the context of this submission, it is worth referring to the current initiatives that the government has undertaken dealing with taxation reform and the NFP sector. In particular, the current review being conducted by the NFP Sector Tax Concession Working Group (Working Group) on various aspects of the tax concessions currently being provided to NFPs. Although the Working Group’s discussion paper titled “*Fairer, simpler and more effective tax concessions for the not-for-profit sector*” is stated as being put forward merely to gather information to assist in evaluating each option discussed in the Discussion Paper, there is a perception that the underlying focus is to pare back on the overall government subsidies assisting all areas of the NFP industry. This view is supported by the so called reform of salary sacrificed ‘in-house’ fringe benefits (the subject of the proposed changes under this discussion) which, if enacted, will have a detrimental financial impact on NFPs, including the independent school sector in particular.

It is relevant to note that ISCA has made submissions in respect of a number of consultation questions raised in the discussion paper that are relevant to the ongoing operations of independent schools. These submissions are currently before the Working Group for consideration and we hope that our views are given favourable consideration in any final recommendations by the Working Group.

The following commentary will focus on the adverse implication for the schools sector should the so-called in-house fringe benefits reforms come into effect.

Current Taxation Position

Independent not-for-profit schools are currently able to offer staff the benefit of providing them with in-house fringe benefits which has been a feature of the fringe benefits tax (FBT) legislation since that legislation came into being. In-house fringe benefits arise when employees receive goods or services from their employer that are identical or similar to those offered to members of the general public in its ordinary course of business.

Structured appropriately, the employer could access an FBT concession whereby the value of in-house fringe benefits is 75% of the lowest price the identical benefits sold to the general public or under an arm's length transaction. Furthermore, the taxable value of the in-house fringe benefits could also be reduced by a further \$1,000 upon meeting certain criteria.

Employers administering programs involving in-house fringe benefits would typically incorporate salary sacrifice arrangements with the view of maximising the benefits to employees at minimal costs.

As part of an overall response to falling government revenue, the Federal Government expects that the proposed measure would raise \$445 million in revenue, as well as an increase in GST payments to the States and Territories of \$85 million, over the 4 year forward estimates period.

It has been proposed that the new measures would apply from 22 October 2012 for salary sacrifice arrangements entered subsequent to the announcement, or from 1 April 2014 for salary sacrifice arrangements entered into prior to the announcement.

In making the announcement, the Government has stated that this change will improve "fairness for employees of firms who do not offer these arrangements". It argues that this change is part of an ongoing process "to ensure the integrity and fairness of the tax system" and has aired the notion that such measures reflect "Labor values" and are aimed at protecting low and middle-income earners in the community. ISCA, however, disagrees with this view and it is submitted that workers in those income categories employed in the education system will in fact be adversely affected if the proposed changes come into effect.

NFP schools offer in-house fringe benefits in the form of discounted school fees. Such arrangements enable schools to attract and retain staff in a tax effective manner. If these changes are introduced, they will force schools to pay higher remuneration costs so that the after-tax positions of their employees are maintained.

It is evident that current in-house benefits programs in place are most beneficial and especially popular amongst employees with taxable income ranges that would be subject to marginal tax rates of 20.5% and 34% (including Medicare Levy), purportedly the exact same class of employees that the Government is seeking to protect. Rather than protecting their financial position, we suggest that, by pursuing this policy, the Government will adversely affect low and middle-income earners (especially in the NFP sector) and have a negative impact on employers who are already struggling within budget constraints in the current tough economic climate. This will be demonstrated by examples below showing the effect on take home pay for such workers.

Example (current rules):

Mary is employed by ABC Private School and salary sacrifices \$15,000 of school fees for her son that attends the school. The figure of \$15,000 is close to the current approximate average cost of educating a child in a government school.

The taxable value of the school fees under the current rules is as follows:

Taxable Value	75% x \$15,000	= \$11,250
Further reduced by the general exemption of \$1,000		= \$(1,000)
Taxable Value		<u>= \$10,250</u>

Tax Impact:

- a) Assuming Mary has already utilised her rebatable threshold on other benefits, fringe benefits is calculated as $\$10,250 \times 1.8692 =$ Grossed up value \$19,159

$$\text{FBT payable } \$19,159 \times 46.5\% = \underline{\underline{\$8,908}}$$

- b) Assuming Mary has utilised her rebatable threshold towards this benefit, fringe benefits is calculated as $\$10,250 \times 1.8692 =$ Grossed up value \$19,159

FBT	$\$19,159 \times 46.5\%$	= \$ 8,908
Less: 48% rebate		<u>\$(4,275)</u>
FBT Payable		<u>\$ 4,633</u>

Example (proposed rules):

The taxable value of the school fees under the proposed rules is as follows:

Taxable Value \$15,000 Note: There are no reductions.

The proposed rules will take place from 1 April 2014 where an existing arrangement was in place at 21 October 2012, otherwise the rules come into effect on 22 October 2012.

Tax Impact:

- a) Assuming Mary has already utilised her rebatable threshold on other benefits, fringe benefits is calculated as $\$15,000 \times 1.8692 =$ Grossed up value \$28,038

$$\text{FBT payable } \$28,038 \times 46.5\% = \underline{\underline{\$13,038}}$$

- b) Assuming Mary has utilised her rebatable threshold towards this benefit, fringe benefits is calculated as $\$15,000 \times 1.8692 =$ Grossed up value \$28,038

FBT	$\$28,038 \times 46.5\%$	= \$13,038
Less: 48% rebate		<u>\$(6,258)</u>
FBT Payable		<u>\$ 6,780</u>

Summary of Employee Tax Impact

Scenario	Current Rules FBT	Proposed Rules FBT	Difference FBT
a) No rebate	\$ 8,908	\$13,038	\$4,130
b) Utilisation of rebate	\$ 4,633	\$ 6,780	\$2,147

All things being equal, an employee salary sacrificing \$15,000 worth of salary towards in-house benefits will be \$4,130 (\$79 per week) worse off in net terms (in the case where the rebate is not being utilised) and \$2,147 (\$41 per week) worse off in net terms where the rebate is applied against the FBT liability.

As indicated in our submissions to the Working Group in response to the discussion paper, we do not support the introduction of direct support as a replacement to the current FBT concessions. Independent schools need surety at the time a potential new employee is being considered for appointment and their remuneration contract is negotiated as to what “benefits” or concessions are available to them. An important element of any such remuneration would involve the potential extra after-tax take home pay in utilising available in-house fringe benefits.

How the Changes Impact Independent Schools

It is unclear if the intention of the Government was to target the not-for-profit sector with the proposed FBT changes. However, what is clear is that the whole non-government school sector, in providing services to the general public, will be greatly impacted by these changes to FBT concession accessed through salary packaging arrangements. In a time of future funding uncertainty (in particular the outcome of the Gonski review of school funding arrangements from 2014), it is of great concern to the sector to see staffing benefits eroded by the Government’s proposal.

The independent schooling sector appreciates this capacity to access FBT concessions for its employees as a means of “value adding” to their contribution to the NFP sector. Staff of non-government schools broadly access benefits across the areas of in-house benefits (school fees in particular), remote area housing benefits (extremely important for schools in rural and remote areas) and salary packaging (a means of attracting, rewarding, and keeping highly competent staff in the sector). A phasing out of FBT concessions would lead to significant increased pressure on wage rates in the sector and to a substantially reduced capacity to attract good staff, particularly to more rural or remote areas.

The impact of any change to the in-house fringe benefits rules will either see a real reduction in school revenue or a similar reduction in the value of employee remuneration in schools. It is submitted that the resulting adverse financial impact on independent schools would see more pressure on governments to provide more funding to make up for budget shortfalls with the effect that any perceived savings from the proposed measure would be illusory.

School fees are a sensitive issue in the independent school sector and if the only option for schools was to increase fees to parents then enrolments could be negatively affected. The perceived taxation savings could be further impacted if there was a resultant enrolment shift from non-government to government schools where public funding requirements are on average more than double the public cost of students attending non-government schools.

Schools not only need to attract suitably qualified teaching staff, but also compete in an open market for staff in educational support areas such as finance, IT, maintenance, nursing, administration, catering etc. The provision of limited fringe benefits assists greatly in being able to attract and retain such staff.

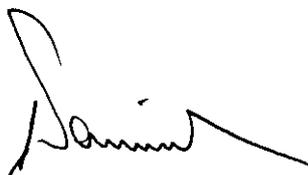
In the area of schooling, there are also no issues of competitive neutrality as all non-government schools can access the same FBT concessions as they are offered currently. Employment in a charity does not attract the same salary scales as in a similarly sized for-profit entity with the FBT benefits allowing an opportunity to make the package more attractive.

As a principle, any system that maintains the benefit to the employee and therefore to the NFP entity and reduces the burden of compliance on the employer is worthy of consideration. Currently, the ability to provide in-house fringe benefits allows the employer to offer a benefit to the employee at an overall reduced cost to both the employer and the employee.

Independent schools operate in a dynamic environment which is influenced not only by changing societal expectations, demographics and world financial markets, but also by changing government policy. The Australian Government's education reform agenda has a significant impact on the operations of individual independent schools, including through non-government schools' funding agreements with the Government. Any additional levels of uncertainty or increase in operating expenditures relating to their role and responsibilities as a charity could have a significant impact on the operating environments for independent schools which would no doubt put more pressure on Government to provide additional financial assistance to allow for the proper administration of the schools sector. Any changes to the in-house fringe benefits rules in these circumstances would be counterproductive.

ISCA looks forward to providing any further comments or evidence either in writing or by attendance at any hearing that may be called by the Committee in respect of its review on the new legislation.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Daniels', with a long horizontal stroke extending to the right.

Bill Daniels
Executive Director

Attachment 1 - Independent School Facts

Number of school employees	76,914
Salaries and wages all staff	\$4.75b
Superannuation contributions	\$456m
Total school recurrent income (all sources)	\$7.49b
Total school recurrent expenditure	\$7.85b
Tuition fees charged for educational services	\$3.44b
Bursaries and fee relief provided to families	\$350m

Sources of income for independent schools

Private sources of funding (mainly parents)	55%
All government sources	45%

The proportions of private/government funding vary greatly from school to school.

Estimated savings to governments from the independent schools sector	\$3.9 billion p.a.
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Public funding of independent schools

All state and territory governments and the Australian Government share responsibility for the public funding of schools in Australia. State and territory governments are the main public funding sources for government schools, while the Australian Government is the main public funding source for non-government schools.

Average Government recurrent funding per student (2009-10)	
Government school	\$14,380
All non-government schools	\$7,427
Independent school	\$6,450

Capital Funding

Parents and donors in independent school communities contribute approximately 80% of funds for capital developments, such as school buildings, grounds and equipment.

Note – The statistics provided in “Independent School Facts” are primarily derived from the 2010 Financial Questionnaire provided by independent non-Catholic schools to DEEWR and as summarised on My School website.